

Message Text

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ACTION EB-07

INFO OCT-01 ARA-06 ISO-00 ERDA-05 AID-05 CEA-01 CIAE-00

CIEP-01 COME-00 DODE-00 FEAE-00 FPC-01 H-02 INR-07

INT-05 L-03 NSAE-00 NSC-05 OMB-01 PM-04 USIA-06

SAM-01 OES-03 SP-02 SS-15 STR-04 TRSE-00 PA-01 PRS-01

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R 032212Z FEB 76

FM AMEMBASSY QUITO

TO SECSTATE WASHDC 8906

INFO AMCONSUL GUAYAQUIL

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E.O. 11652: N/A

TAGS: EFIN, ENRG, EC

SUBJECT: CAYMAN ALLOWED TO AMORTIZE TOTAL PRE-PRODUCTION COSTS IN
FIVE YEARS

REF: WOODS-MARKER MEMCON, JANUARY 13

1. THE GOE ANNOUNCED IN THE PRESS JANUARY 26 AN EXECUTIVE DECREE DATED JANUARY 2 WHICH ALLOWS ACCELERATED DEPRECIATION OF TOTAL PRE-PRODUCTION COSTS FOR HEAVY-CRUDE PRODUCERS. CAYMAN IS THE ONLY OPERATOR AFFECTED, AND HAD BEEN EXPECTING THIS ACTION FOR SOME TIME. ACCELERATED DEPRECIATION IS PART OF A PACKAGE DESIGNED BY THE PREVIOUS MINISTER OF NATURAL RESOURCES, JAIME DUENAS, SPECIFICALLY TO PROVIDE INCENTIVES FOR CAYMAN AND, MORE GENERALLY, TO ENCOURAGE THE DEVELOPMENT OF HEAVY CRUDE DEPOSITS. THE CURRENT MINISTER OF NATURAL RESOURCES, COL. RENE VARGAS, WHO WAS APPOINTED TO THE OFFICE ON JANUARY 13, IS NOT EXPECTED TO PRESS FOR ANY CHANGE IN THE DECREE OF JANUARY 2.

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2. UNDER THE NEW LAW, ALL PRE-PRODUCTION COSTS CAN BE

AMORTIZED IN FIVE YEARS ON A PER-UNIT-OF-PRODUCTION BASIS INSTEAD OF THE PREVIOUS TEN-YEAR STRAIGHT-LINE BASIS IN EFFECT. IN ADDITION, THE DEFINITION OF PRE-PRODUCTION COSTS IS EXPANDED UNDER THE NEW LAW TO INCLUDE INVESTMENTS IN AREAS THAT REVERTED TO THE STATE, AND TO INCLUDE THE COSTS OF DRY WELLS (WHICH COSTS WERE PREVIOUSLY SET ASIDE IN A SPECIAL ACCOUNT TO BE AMORTIZED OVER TEN YEARS).

3. ACCORDING TO THE CAYMAN ASSOCIATION CONTRACT, CEPE IS TO RECEIVE 5 TO 7 PERCENT OF CAYMAN'S PROJECTED PRODUCTION LEVEL OF 35,000 - 40,000 BPD. FOLLOWING IS INFORMAL EMBASSY TRANSLATION OF DECREE: QUOTE:

EXECUTIVE DECREE 02, JANUARY 2, 1976: CONSIDERING:
THAT EXPLORATION IN THE ORIENTE CONFIRMS THE EXISTENCE OF DEPOSITS OF HEAVY CRUDES; THAT EXPLOITATION OF THESE DEPOSITS WILL BE POSSIBLE AT A HIGH COST;

THAT THESE CRUDES ARE NOT NOW COMMERCIALY EXPLOITABLE, SINCE THE TAX SYSTEM NOW IN EFFECT APPLIES ONLY TO LIGHT CRUDES; THAT IT IS NECESSARY TO ESTABLISH AN ADEQUATE ECONOMIC TREATMENT TO ENCOURAGE THE DEVELOPMENT OF HEAVY CRUDE DEPOSITS AND CONTRISTE TO INCREASED REVENUES FOR THE STATE; THAT DECREE 1383, DECEMBER 14, 1973, PUBLISHED IN OFFICIAL REGISTER 457, DECEMBER 20, 1973, ESTABLISHED THE ACCOUNTING PRACTICES FOR THE PETROLEUM COMPANIES, IN PARTICULAR FOR THE RECOVERY OF EXPLORATION AND EXPLOITATION INVESTMENTS:

DECREE: THE FOLLOWING SPECIAL ACCOUNTING PRACTICES TO CALCULATE THE COST OF PRODUCTION IN A MANNER PROVIDING FOR THE ACCELERATED RECOVERY OF INVESTMENTS WILL APPLY TO THE PETROLEUM COMPANIES AUTHORIZED BY THE GOVERNMENT IN THE FOLLOWING CASES.

ARTICLE 1: COMPANIES WITH ASSOCIATION CONTRACTS AND WITH CRUDE RESERVES OF LESS THAN 28 API SHALL BE SUBJECT TO THE SPECIAL ACCOUNTING PRACTICES.

ARTICLE 2: WITH THE EXCEPTION OF THE DIRECT COSTS OF EXTRACTION MADE IN THE PRE-PRODUCTION PERIOD WHICH WILL LIMITED OFFICIAL USE

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BE CHARGED TO THE FIRST YEAR OF PRODUCTION, ALL EXPENSES UNTIL THE FIRST DAY OF COMMERCIAL PRODUCTION WILL BE CONSIDERED AS PRE-PRODUCTION INVESTMENTS AND WILL BE CAPITALIZED FOR RECOVERY IN FIVE YEARS BY A PER-UNIT-OF-PRODUCTION AMORTIZATION. THIS METHOD WILL BE ESTABLISHED BY REGULATION OF THE MINISTRY OF NATURAL RESOURCES IN A MAXIMUM PERIOD OF SIXTY DAYS.

ARTICLE 3: TO CALCULATE CEPE'S PARTICIPATION IN PRODUCTION, ACCORDING TO NO. 22.1 OF ARTICLE 1 OF THE BASES FOR ASSOCIATION CONTRACTS FOR EXPLORATION OF PETROLEUM RESERVES AND EXPLOITATION OF PETROLEUM, ESTABLISHED BY DECREE NO. 316, MARCH 27, 1973, PUBLISHED IN THE OFFICIAL REGISTER 281, APRIL 6, 1973, ONLY NET PRODUCTION WILL BE CONSIDERED. THE DEFINITION OF NET PRODUCTION IS TOTAL PRODUCTION LESS ROYALTIES, LESS PETROLEUM SOLD FOR INTERNAL CONSUMPTION, AND LESS THE PETROLEUM EARMARKED FOR RECOVERY OF EXPLORATION INVESTMENTS. EXPLORATION INVESTMENTS WILL BE DIFFERENTIATED FOR THIS PURPOSE, SINCE THEY ARE PART OF THE PRE-PRODUCTION INVESTMENTS BY THEIR PARTICULAR NATURE.

ARTICLE 4: THE PROVISIONS OF DECREE NO. 1383, DECEMBER 14, 1973, PUBLISHED IN THE OFFICIAL REGISTER 457, DECEMBER 20, 1973, WILL BE INCORPORATED INTO THIS ACCOUNTING PRACTICE, PROVIDED THEY ARE NOT CONFLICTING.

ARTICLE 5: THE PRESENT DECREE WILL SUPERSEDE ALL CONFLICTING REGULATION. THE MINISTER OF NATURAL RESOURCES AND THE MINISTER OF FINANCES ARE CHARGED WITH ITS EXECUTION. DECREED IN THE NATIONAL PALACE, QUITO, JANUARY 2, 1976; JAIME VICENTE SALAZAR, ACTING MINISTER OF NATURAL RESOURCES; JAIME MORILLO BATTLE, MINISTER OF FINANCES. UNQUOTE.
BREWSTER

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Margaret P. Grafeld
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